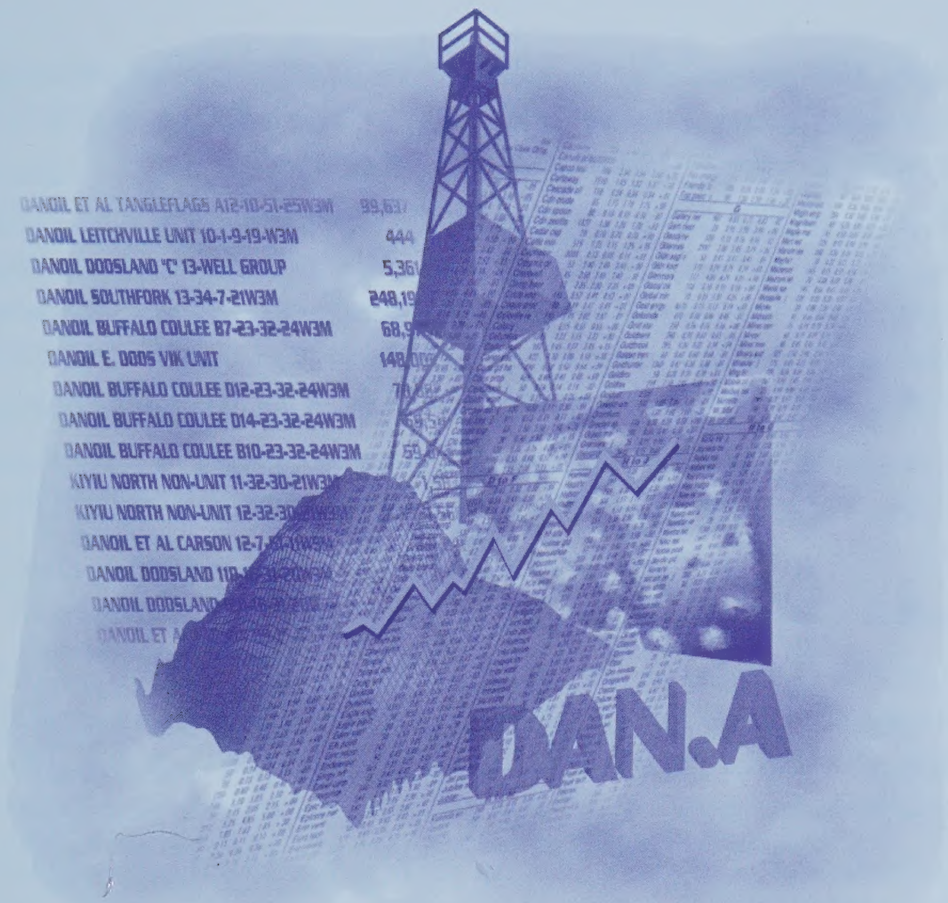
1996 Annual Report



Maximizing Shareholder Value by Effectively Managing Oil and Gas Assets

Danoil considers itself an asset management company. As such, Danoil's business strategy is to maximize the value of its oil and gas assets through development drilling and production optimization as well as a strong emphasis on the financial aspects of the business (i.e., tax driven acquisitions and creative financing). Historically, the company prefers to buy undervalued assets, ideally with associated tax pools, fully develop them and sell them at greater values. The proceeds of sales have been reinvested in more attractive oil and gas opportunities. Danoil continues to increase its working interest positions where upside potential exists as well as to acquire offsetting production and acreage to take advantage of the company's existing infrastructure and operations. Danoil continues to use all available technology to fully develop its prospects.

DANOIL ENERGY LTD.

Message to the Shareholders

In keeping with Danoil's goals to be an asset management organization, Danoil returned 22% on shareholders equity and 13% on market capitalization in 1995/96. These numbers are considerable improvements over 1994/95 and represent Danoil's desire to improve its balance sheet and strengthen its operations.

During the year, Danoil drilled 17 wells (14 net). We completed 3 gas wells and 14 oil wells with Danoil as operator. Danoil has been working actively to expand our gas operation in 1996. We successfully brought on gas wells in Penhold and Tangleflags by recompleting existing wells, and putting in place construction projects which will start gas flowing in Carson Creek and Paintearth. We also completed studies which will bring more gas onto production in Lloydminster and Dodsland. We still have over 200 drillable locations on Danoil's lands in light, medium and heavy oil and gas plays.

In 1996, Danoil replaced its reserves by 122% of production. We now have 10,715,000 boe's of proven and probable (risked) reserves which at the rate of production of 786,000 boe's/year (1995/96 production) is 13.6 years of reserve life.

Production for the year was up 11% over 1994/95 ending with a yearly average of 2,153 boe's per day.

In 1994/95, Danoil felt that prices for crude oil had peaked so we forward sold a portion of our crude oil. This effectively protected us for the first half of the year, but as prices climbed into the summer we lost the advantage. During 1995/96 this activity reduced our crude revenues by $0.87/barrel. Most of these sales conclude in February 1997 and we have not forward sold additional oil during this year.

Because of a reduction of operating costs to $10.04/boe a saving of $0.84 helped to produce a net back of $7.75/boe, an improvement of $0.12 over 1995 and $1.26 over 1994. We received an average price of $19.94/boe in 1995/96.

Prices of producing properties have increased markedly and Danoil's net asset value (at a 12% discount) is now $2.68/share. While it is possible to sell properties at these, or better prices, small cap producers have not seen these values reflected in their stock prices. We expect this situation to change as the number of producing properties declines through absorption in Royalty Trust financings and other sales.

We are confident that Danoil's philosophy of asset management will result in a market recognizing the very low price of our shares.

Continued success in our drilling programs, cost reduction measures and asset management will give us a company with which shareholders, staff and customers alike will be proud to be associated.

Robert G. Brawn
President & CEO

December 19, 1996

Management's Discussion and Analysis

Management has prepared the following discussion and analysis of financial results based on information for the years ended August 31, 1996 and 1995.

Overview

The financial results for the 1996 year reflect our ability to sustain growth, increase earnings and strengthen shareholders' equity.

Our 1996 exploration and development program (net of dispositions) was funded by cash flow and debt.

Danoil enters 1997 with a growth strategy that will be guided by a prudent approach to risk management. Our emphasis in 1997 is changing from predominantly oil to increased production of gas.

Summary Comparisons 96 vs 95

	1996	1995	Change
Oil and Gas Revenue (000's)	$ 15,671	$ 15,044	4%
Cash Flow (000's)	$ 4,248	$ 4,031	5%
Net Income (000's)	$ 2,891	$ 1,507	92%
Oil and Gas production (Boe's)	785,936	708,465	11%
Production (Boe's/d)	2,153	1,941	11%

Revenue

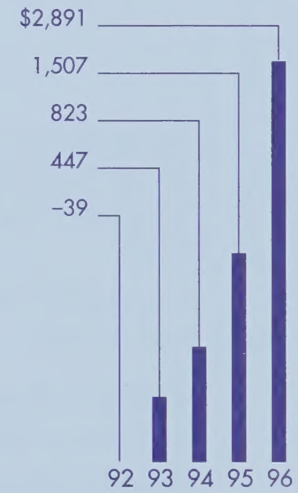
Oil and gas sales rose 4% to $15.7 million from $15.0 million in 1995. The higher revenue was attributable to increased production volumes. Production rose 11% in 1996 to 785,936 boe's from 708,465 boe's in 1995. Our average price per boe dropped from $21.23 in 1995 to $19.94 in 1996. This was caused by lower prices, averaging $17.52/boe, in the first half of the year which offset the higher prices for the second half, which averaged $22.68/boe.

In order to mitigate against the risk associated with a decline in the price of oil, we entered into forward oil sales in connection with 58% of the company's 1996 production and a portion of our 1997 production. As a result of these forward sales, our share of the increased oil prices in 1996 was not as great as it would have been otherwise.

Had we not entered into these forward sales, we would have received an additional $685,685 in revenue in 1996 ($0.87/boe) and $80,721 in revenues in 1995 ($0.11/boe).

One third of the forward sales in 1996 were entered into as part of the contract where we sold forward $6,200,000 of oil which utilize available business losses carried forward which would have expired. This contract effectively forward sold 389,200 barrels of oil over a 32 month period starting September 1, 1995, at a price of $25.80 per barrel (WTI) after tax.

We have also forward sold 290,000 barrels in 1997 at an average WTI price of $25.48 before adjusting for quality differentials. These forward sales expire in February 1997.



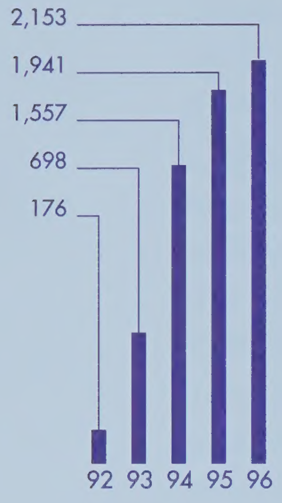
Earnings
($000)

Royalties

Royalties increased 12% from $1,512,995 to $1,689,802 in 1996. This increase was consistent with increased production volumes. Also, on the forward sold production, royalties payable were calculated based on the higher market price rather than the forward sale price. As a percentage of sales, the royalty rate rose slightly to 12% from 11% of oil and gas revenues.

	1996	1995	Change
Resource Surcharge	$ –	$ 426	
Royalties	1,690	1,513	12%
Total Royalties	$ 1,690	$ 1,939	

Management's Discussion and Analysis



BOE's / Day

Production Costs

Production costs rose 3% from $7,693,026 to $7,895,417 in 1996. This was due to an increased volume of production and from continued efficient operation by our field contractors. This year, our operating cost per boe dropped 8% from $10.86 to $10.04.

In 1997, operating costs per boe are expected to decline with continued realization of efficiencies, increased production and cost savings due to the divestiture of some marginal (high operating cost) properties sold prior to the 1996 year end.

Danoil operated 558 wells at the 1996 year end (594 wells - 1995).

Netback Per Boe

	1996	1995	Change	1994
Gross Revenue Price	$ 20.81	$ 21.34	-2%	$ 17.18
Hedging loss	(0.87)	(0.11)	–	–
Average Revenue Price	19.94	21.23	-6%	17.18
Less:				
Royalties, net of ARTC	2.15	2.74	-21%	1.21
Production	10.04	10.86	-7%	9.58
Netback per boe	$ 7.75	$ 7.63	2%	$ 6.39

General and Administrative – (G&A)

Total general and administrative expenses increased by 35% in 1996 as a result of increased staff, consulting costs and contractor fees. Public company costs and directors' fees increased G&A over that incurred in 1995 as this was the first full year for Danoil as a public company.

We capitalized on $210,000 of G&A expenses in 1996 related to exploration and development expenditures (being 10% of G&A after overhead recoveries).

Depletion and Amortization – (D&A)

The D&A provision increased 21% from $1,463,000 in 1995 to $1,767,000. D&A per boe increased from $2.06 to $2.25 in 1996.

Each year Danoil completes a "Ceiling Test" pursuant to generally accepted accounting principles. The test compares book value to the estimated future cash flow from the proven reserves based on year end prices less production and administrative costs, income taxes and capital expenditures. The sales prices used were year end prices of $24.80/bbl for oil and $1.15/mcf for gas, held constant for future years. At year end, Danoil had a significant cushion between the book value and estimated future cash flow.

Income Taxes

Deferred taxes payable fell to $1.9 million from $2.3 million in 1995 due to the utilization of pool deductions and losses carried forward that were acquired in a 1994 amalgamation. A recovery of income taxes, in the amount of $0.381 million, was shown in 1996 versus a tax expense of $1.1 million in 1995. These tax recoveries in 1996 were also a result of the tax effect of utilization of losses carried forward that were realized through our forward oil sale contract.

Danoil has an additional $3.7 million of tax losses available to offset revenue in future years. These losses or related tax savings have not been recognized in the accounting records.

Management's Discussion and Analysis

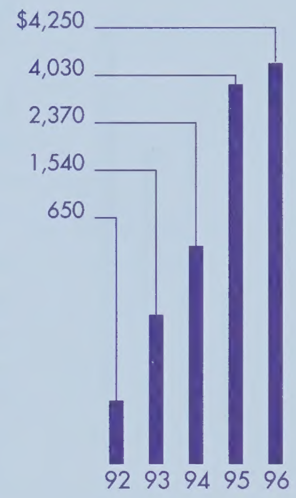
In addition, Danoil has the following estimated tax pools to offset future income tax liabilities:

	Deduction	1996	1995
Non-capital Losses	100%	$ 2,200,000	$ –
Canadian Exploration Expense	100%	674,000	4,361,000
Canadian Development Expense	30%	414,000	3,292,000
Canadian Oil & Gas Property Expense	10%	14,350,000	5,559,000
Foreign Exploration & Development Expenses	10%	461,000	513,000
Undepreciated Capital Cost	various rates	2,657,000	1,170,000
	Total	$ 20,756,000	$ 14,895,000

Cash Flow and Net Earnings

Danoil reported cash flow from operations of $4,247,691 or $0.30 per share basic for the year ended August 31, 1996. This represented a 5% increase over cash flow generated last year ($4,030,937 and $0.30 per share basic). On a fully diluted basis, cash flow per share in 1996 dropped 2 cents from $0.29 in 1995 to $.27.

Net earnings in 1996 increased 92% over those in 1995. This was mainly due to reduced royalty expenses and from the utilization in 1996 of losses carried forward from prior years and previously not recognized.



Cash Flow
($000)

Liquidity and Capital Resources

At August 31, 1996, Danoil has a working capital deficiency of $2.4 million which arises mainly from the obligation over the next 12 months under the forward oil sale contract. The long-term debt is $5.5 million, giving a total indebtedness of $7.9 million. The unused portion of Danoil's banking facility at year end amounted to $5.8 million.

Capitalization	Aug-31 1996	%	Aug-31 1995	%
Working Capital Deficiency (Excess)	$ 2,394	8	$ (2,088)	(7)
Long Term Debt	5,484	17	7,306	24
Deferred Income Taxes	1,892	6	2,302	8
Market Value of Shares Outstanding, at November 9, 1996 and 1995	21,994	69	22,517	75
Total ($000's)	$ 31,764	100	$ 30,037	100

Capital Expenditures

Capital expenditures during 1996 declined slightly to $9,196,999 from $9,499,000 in 1995.

Our reserve additions were 122% of production in 1996.

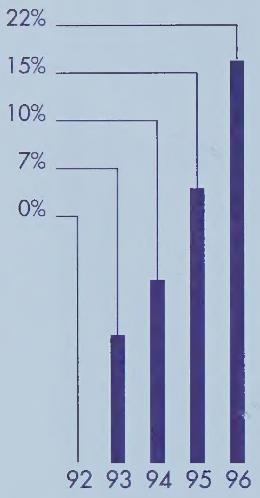
The following table provides an analysis of finding and disposition costs on a boe basis for Danoil's proven and probable reserves:

	(000's)	Boe's (000's)	$/Boe
Reserves at August 31, 1995		10,481	
Property acquisitions	$ 347	149	$ 2.33
Exploration and development	$ 8,849	1,188	$ 7.45
Property dispositions	$ (2,169)	(317)	$ 6.84
Production		(786)	
Reserves at August 31, 1996		10,715	

Management's Discussion and Analysis

Net Asset Value Per Share
August 31, 1995

	Discount Rate	
	12%	15%
Reserves net present value	$ 50,723,000	$ 43,521,000
Working capital deficiency	(2,393,750)	(2,393,750)
Long term debt	(5,484,048)	(5,484,048)
Net Asset Value	$ 42,845,202	$ 35,643,202
Net asset value per fully diluted Class A Share	**$ 2.68**	**$ 2.23**



Return on Equity

Share Trading History

During the year, 700,295 Class A shares traded on the Alberta Stock Exchange and fluctuated between a low of $1.10 and a high of $1.80. Our stock closed at $1.35 on August 31, 1996.

Business Risks and Outlook

Companies involved in the exploration for and the production of oil and natural gas face a number of risks and uncertainties inherent in the industry. Danoil's performance is influenced by a number of factors including commodity pricing, transportation and marketing constraints, and government regulation and taxation.

Oil prices are influenced by global supply and demand conditions as well as world wide political events. The price Danoil receives for its oil is further adjusted by gravity and other quality factors of the oil, and transporting it to market through pipelines. The impact of the pricing differential between light and heavy oil on Danoil's average wellhead price is significant inasmuch as a large amount of Danoil's production involves heavy oil. As the price of oil in Canada is based on a US benchmark price, variations in the Canada/US exchange rate further affects Danoil's oil prices. Danoil has utilized a forward oil sales program to offset the exposure to the decline of oil prices and currency fluctuations.

The oil and gas industry is subject to extensive controls, regulatory policies and income taxes imposed by various levels of government. These controls and policies, as well as income tax laws and regulations, are amended from time to time. The company has no control over government intervention or taxation levels in the oil and gas industry, however, it operates in a manner to ensure that it is in compliance with all regulations and is able to respond to changes as they occur.

Danoil's operations are subject to the risks normally associated with the oil and gas industry including hazards such as unusual and unexpected geological formations, high reservoir pressures and other conditions involved in drilling and operating wells. We minimize these risks using prudent safety programs and risk management, including insurance coverage against potential losses.

Danoil recognizes that the industry is faced with an increasing awareness with respect to environmental impact of oil and gas operations. Danoil has reviewed the environmental risks to which it is exposed and has determined that there is no current material impact on the companies operations. However, the cost of complying with environmental regulations is increasing. Danoil will ensure continued compliance with environmental regulations and legislation.

Management's Responsibility for Financial Statements

The accompanying consolidated financial statements of Danoil Energy Ltd. have been prepared by management in accordance with generally accepted accounting principles.

The Company's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable. Management is satisfied that these financial statements have been prepared accordingly and within reasonable limits of materiality. Further, management is satisfied that the financial information throughout the balance of this annual report is consistent with the information presented in the financial statements.

Independent auditors have been appointed by the shareholders of Danoil. They have examined the financial statements of the Company for the years ended August 31, 1996 and 1995, and the auditor's opinion is expressed herewith.

The Audit Committee has reviewed these statements with management and the auditors, and has reported to the Board of Directors. The Board has approved the financial statements of Danoil which are contained in this annual report.

Calgary, Alberta
November 12, 1996

Donald S. Milne, BComm, CMA
Controller

Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Danoil Energy Ltd. as at August 31, 1996 and 1995, the consolidated statements of income and retained earnings, and changes in financial position for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at August 31, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Davis, Daignault, Schick & Co

Calgary, Alberta
November 1, 1996

Chartered Accountants

Consolidated Balance Sheets

August 31	1996	Restated 1995
ASSETS		
Current assets:		
Cash and short-term investments	$ 305,724	$ 160,430
Accounts receivable	3,846,773	2,394,798
Forward oil sale receivable	–	6,220,000
Inventory	482,012	463,343
Prepaid expenses	999,586	642,014
	5,634,095	9,880,585
Property and equipment - Note 3	29,037,850	22,010,685
Accumulated depletion and amortization	(5,874,595)	(4,107,100)
	23,163,255	17,903,585
	$ 28,797,350	$ 27,784,170
LIABILITIES & SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,655,793	$ 5,678,847
Forward oil sale contract - Note 5	2,372,052	2,114,009
	8,027,845	7,792,856
Long-term liabilities:		
Bank debt - Note 4	4,200,000	3,200,000
Forward oil sale contract - Note 5	1,284,048	4,105,991
	5,484,048	7,305,991
Deferred income taxes	1,891,930	2,302,402
Shareholders' equity:		
Share capital - Note 7	7,852,071	7,682,070
Retained earnings	5,541,456	2,700,851
	13,393,527	10,382,921
	$ 28,797,350	$ 27,784,170

On behalf of the Board:

Director

Director

Consolidated Statement of Income and Retained Earnings

For the Years Ended August 31	1996	Restated 1995
Income:		
Oil and natural gas revenue	$ 15,671,408	$ 15,043,660
Royalties and resource taxes	(1,689,802)	(1,939,428)
	13,981,606	13,104,232
Expenses:		
Production	7,895,417	7,693,026
General and administrative	1,808,942	1,352,489
Depletion and amortization	1,767,496	1,462,860
	11,471,855	10,508,375
Net income before income taxes	2,509,751	2,595,857
Income taxes - Note 6		
Current	29,556	27,780
Deferred	(410,472)	1,061,005
	(380,916)	1,088,785
Net income for the year	2,890,667	1,507,072
Retained earnings, beginning of year as restated (Note 9)	2,700,851	1,762,681
Dividends	(50,062)	–
Repurchase of stock options	–	(568,902)
Retained earnings, end of year	$ 5,541,456	$ 2,700,851
Earnings per share:		
Basic	$ 0.20	$ 0.11
Fully diluted	$ 0.18	$ 0.11

Consolidated Statement of Changes in Financial Position

For the Years Ended August 31	1996	Restated 1995
Cash provided by (used in):		
Operations:		
Net earnings	$ 2,890,667	$ 1,507,072
Items not involving cash:		
Depletion and amortization	1,767,496	1,462,860
Deferred income taxes	(410,472)	1,061,005
Funds from operations	4,247,691	4,030,937
Increase (decrease) in non-cash working capital	4,368,730	(3,919,346)
	8,616,421	111,591
Investments:		
Net additions to property and equipment	(7,027,165)	(8,425,683)
Financing:		
Increase in long-term debt	1,000,000	800,000
(Repayment) proceeds of forward oil sale contract	(2,563,900)	6,220,000
Issue of common shares	170,000	1,859,217
Dividends payable	(50,062)	–
Repurchase of stock options	–	(568,902)
	(1,443,962)	8,310,315
Increase (decrease) in cash position	145,294	(3,777)
Cash position, beginning of year	160,430	164,207
Cash position, end of year	$ 305,724	$ 160,430
Cash flow per share:		
Basic	$ 0.30	$ 0.30
Fully diluted	$ 0.27	$ 0.29

Notes to the Consolidated Financial Statements

Note 1 - Significant Accounting Policies

The Company, which is incorporated under the laws of Alberta, is principally involved in the exploration, development and production of oil and natural gas in Canada.

a) Basis of Consolidation

The financial statements include the accounts of the company and wholly owned subsidiaries; 613312 Saskatchewan Ltd., 613381 Saskatchewan Ltd. and 557901 Alberta Inc. (1995 - 557901 Alberta Ltd and Danoil Inc.). Danoil Inc. was dissolved as of September 1, 1995.

b) Oil and Natural Gas Operations

The company follows the full cost method of accounting for oil and gas operations, whereby all costs associated with the exploration for, and development of oil and natural gas reserves are capitalized by cost centre. Such costs include land, acquisition expenditures, geological and geophysical expenses, carrying charges of nonproductive properties, costs of drilling wells, gathering and production facilities, and financing and administrative costs directly related to capital projects. Proceeds from the sale of any interests in oil and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a disposition would alter the rate of depletion by at least 20%.

Depletion of oil and gas properties is calculated using the unit-of-production method based on estimated net proven reserves, as determined by the Company and reviewed yearly by independent consulting engineers, and converted to a common unit of measure using a relative energy content.

The company applies a ceiling test to ensure that capitalized costs (net of accumulated depletion) do not exceed the estimated future net revenues from production of proven reserves, at year end prices and costs, less estimated future administrative, financing and income tax costs.

Depreciation for non-resource equipment is provided for using the declining balance method at rates between 20% and 30%.

(c) Joint Venture Accounting

A portion of the company's oil and natural gas operations are conducted jointly with others, and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

(d) Prepaid Forward Sale Contracts

Prepayments received under forward sale contracts for oil not delivered are deferred and recognized as revenue when deliveries are made.

(e) Financial Instruments

The company has entered into various contracts to reduce its exposure to price declines and currency rate fluctuations on a portion of its oil production. Gains or losses related to these contracts are recorded as adjustments to revenue in the period of realization.

Notes to the Consolidated Financial Statements

(f) Earnings and Cash Flow Per Share

Earnings per share amounts have been computed using the weighted average number of shares outstanding during the year of 14,131,372 shares (1995 - 13,390,749 shares). Fully diluted earnings per share assumes the exercise of all rights to acquire shares which have a dilutive effect; the conversion of Class B Common shares, Class D Preferred shares and outstanding Class A Common stock options.

(g) Inventory Valuation

Inventory of oil is priced at year end market prices.

(h) Temporary Investments

Temporary investments are carried at the lower of cost and net realizable value.

Note 2 - Business Combination

On September 1, 1995, Danoil Energy Ltd and Manchester Resources Corporation (an Alberta public company) were amalgamated. Danoil had acquired control of Manchester in a reverse takeover on August 11, 1995. The amalgamated entity continued under the name of Danoil Energy Ltd..

The combination was accounted for using the purchase method, with the cost of the purchased assets determined by the fair value of Manchester's net assets, and detailed as follows:

Working Capital Deficiency	$ (55,646)
Petroleum and Natural Gas Properties	1,409,664
Value reflected in share capital	$ 1,354,018

Note 3 - Property and Equipment

	1996	1995
Oil and gas property and equipment	**$ 23,690,151**	$ 21,717,248
Undeveloped property not subject to depletion	**4,786,747**	–
Less accumulated depletion	**(5,668,568)**	(3,984,930)
	22,808,330	17,732,318
Capital Assets	**560,952**	293,437
Less accumulated amortization	**(206,027)**	(122,170)
	354,925	171,267
	$ 23,163,255	$ 17,903,585

During the year, interest charges on the long-term debt of $986,225 (1995 - $384,812) relating to acquisition and development activities were capitalized.

Management has estimated the salvage value of wellsite equipment to be in excess of the cost of abandoning the properties. Accordingly, no liability has been recorded for future site restoration costs.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Bank Debt

	1996	1995
	$ 4,200,000	$ 3,200,000

The Company has a revolving production loan authorized in the amount of $10,000,000. This loan has no fixed terms of repayment, bears interest at the bank prime rate plus 3/8%, is of a demand nature, and is subject to an annual review by the lender. Under present conditions, the Company does not expect principal repayments will be required within the next year. The loan is secured by fixed and floating charge debentures in the amount of $20,000,000 and a general security agreement over all present and future assets, except for those assets which are specifically assigned to the $25,000,000 debenture, which provide security for the forward oil sale.

Note 5 - Forward Oil Contract Liability

On August 31, 1995, the Company entered into a prepaid contract in the amount of $6,200,000 for the future delivery of oil over a thirty-two month period commencing September 1, 1995. During the year, the company entered into an agreement to prepay the final two months of the contract.

The Company's obligation under this contract is secured by a demand debenture for $25,000,000 over those properties from which production is specifically dedicated .

The remaining liability under the contract is:

	1996		1995	
	Bbls of Oil	**$**	**Bbls of Oil**	**$**
1996	**–**	**–**	146,400	$ 2,114,009
1997	**146,000**	**$ 2,372,052**	146,000	2,372,052
1998	**72,400**	**1,284,048**	96,800	1,733,939
	218,400	**$ 3,656,100**	389,200	$ 6,220,000

Note 6 - Income Taxes

The provision for income taxes reflects an effective rate which differs from the Canadian Income Tax rate of 45.4% (1995 - 45.6%). The differences are as follows:

	1996	1995
Expected tax provision	**$ 1,074,880**	$ 1,379,071
Increase (decrease) resulting from:		
Resource pools and losses carried forward utilized in year	**(1,545,663)**	(230,332)
Resource deductions	**103,082**	(33,825)
Other	**(13,215)**	(26,129)
Income Taxes	**$ (380,916)**	$ 1,088,785

In 1994 the company acquired certain resource pools and tax losses as the result of an amalgamation. The tax benefit was not recorded in the books, as at the time there was not reasonable assurance that the benefits could be used.

The benefits related to these tax pools are being recognized when utilized.

Notes to the Consolidated Financial Statements

Note 7 - Share Capital

Authorized:

Unlimited number of Class A (subordinate voting) shares.

Unlimited number of Class B voting shares.

(Each Class B share entitles the holder to a number of votes equal to one times the number determined by dividing the total of all shares represented at a shareholder meeting by the total of all Class B shares represented.)

Unlimited number of Class C preferred shares, issuable in one or more series.

Series D1 non-voting cumulative, redeemable, convertible 5% preferred shares: 623,400.

Issued:	1996		1995	
	# of Shares	**Amount**	**# of Shares**	**Amount**
Class A (subordinate voting) Shares				
Balance, beginning of year	**14,073,107**	**$ 7,109,394**	721,915	$ 1,354,018
Issued under reverse takeover	–	–	13,351,192	5,755,376
Issued for petroleum assets	**100,000**	**150,000**	–	–
Issued for cash	**16,529**	**20,000**	–	–
Balance, end of year	**14,189,636**	**7,279,394**	14,073,107	7,109,394
Class B Shares	**3,740**	**10**	3,740	10
Series D1 5% Preferred Shares	**623,400**	**572,666**	623,400	572,666
		$ 7,852,070		$ 7,682,070

Conversion Rights

An agreement has been reached where the Class B shares (held by the President of the Company) will be exchanged for 187,020 Class A (subordinate voting) shares prior to September 1, 1997.

Each Series D1 share is redeemable at $1.6061 per share and is convertible to a Class A (subordinate voting) share. This conversion can take place at any time until December 31, 1999. Dividends are payable annually at a rate of 5% of the redemption value.

Stock Options

The Company has issued stock options to directors, officers and employees under various option plans. At August 31, 1996 the Company has options outstanding for the purchase of the following Class A (subordinate voting) shares:

Date of Grant	# of Shares	Option Price	Expiry Date
01-Sep-93	97,252	$ 1.21	01-Sep-98
05-Oct-95	930,000	$ 1.54	05-Oct-05
	1,027,252		

Notes to the Consolidated Financial Statements

Note 8 - Related Party Transactions

During the year, the company contracted with companies controlled by officers and directors for services of those officers and directors amounting to $607,809 (1995 - $435,963).

The Company contracted with a related company (which is controlled by a director of Danoil) for oil well services at normal market terms amounting to $224,056 (1995 - $290,968).

Properties were acquired from a company, controlled by a director, in exchange for 100,000 Class A (subordinate voting) shares at $1.50 per share. It is the opinion of management that this represented fair market value.

Certain properties were sold to a company controlled by a director of Danoil for an amount which, in the opinion of management, represented fair market value.

Note 9 - Prior Year Restatement

The 1995 statements have been restated to record a liability for Saskatchewan Capital Tax for the years 1993 and 1995. (Danoil and its subsidiaries are not in a taxable position under the Saskatchewan Corporate Capital Tax Act in 1996.)

	1996	1995
Retained Earnings, beginning of year - as previously stated	**$ 2,296,567**	$ 931,964
Contributed Surplus reclassified	**889,282**	889,282
Adjustment re 1993 Capital Tax	**(58,565)**	(58,565)
Adjustment re 1995 Capital Tax	**(426,433)**	–
Retained Earnings, beginning of year - as restated	**$ 2,700,851**	$ 1,762,681

Corporate Information

Danoil Governance

ROBERT G. BRAWN, PENG
President, Chief Executive Officer and Director

ROBERT R. HOBBS, CMA
Vice President, Finance and Director

WAYNE S. WADLEY, CET
Vice President, Production/Operations

REGINALD F. WHYTE, BSC, PLAND
Vice President, Land

DONALD S. MILNE, BCOMM, CMA
Controller

GREGORY C. COLLVER, LLB
Director

FRANK W. KING, PENG
Director

R. CARL SMITH,
Director

NOEL A.CLELAND, PENG
Director

Bankers

ALBERTA TREASURY BRANCHES
Calgary, Alberta

Auditors

DAVIS, DAIGNAULT, SCHICK & CO.
Chartered Accountants
Calgary, Alberta

Legal Counsel

GREGORY C. COLLVER & PAUL D. TROTTER
Barristers and Solicitors
Calgary, Alberta

Engineers

SPROULE ASSOCIATES LIMITED
Calgary, Alberta

Stock Exchange

THE ALBERTA STOCK EXCHANGE
"DAN.A"

Corporate Offices

Suite 500, 505 - 3rd Street S.W.
Calgary, Alberta T2P 3E6

Abbreviations

ARTC	Alberta royalty tax credit
bbls	barrels
boe	barrels of oil equivalent where natural gas is converted to oil on the basis of 10 mcf of gas for each barrel of oil
bopd	barrels of oil and NGLs per day
boe/d	barrels of oil equivalent per day
mcf	thousands cubic feet
mmcf	million cubic feet
mcf/d	thousand cubic feet per day
mbbls	thousand barrels
NGLs	natural gas liquids
WTI	West Texas Intermediate / Cdn. dollars

DANOIL ENERGY LTD.

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